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These Homeowners Are At Risk In Fickle Economy

While it appears most homeowners can rest somewhat easy in today's market, those who used government-backed mortgage to purchase a single-family home in the past few years or took out a large loan to buy at the highest price point in certain areas may be at greater risk of losing property value or feeling pressure on their cash flow, according to real estate professionals.

They said residential real estate finds itself at the mercy of competing and even far-flung forces of a historic nature. Those include the remnants of the COVID-19 pandemic, which drove families away from crowded downtown, the evolution of remote work, which made it possible for Americans to stay employed without going to the office, and geopolitical strife amid Russia's war in Ukraine, which is contributing to supply chain issues and higher costs.

Such complexity, real estate specialists say, makes it hard to predict exactly which single-family homeowners and borrowers might be hardest hit by rising inflation, higher interest rates and negative gross domestic product numbers, especially considering that demographic factors and more than a decade of underbuilding following the Great Recession of the late 2000s are still sustaining a record demand in housing.

According to Rick Sharga, executive vice president of market intelligence at real estate data provider ATTOM, a group that is more likely to suffer in a downturn consists of households with home loans subsidized through Federal Housing Administration and Veteran Affairs Department programs.

"Those borrowers, generally speaking, have less equity, lower cash reserves, lower earnings than people with conventional loans, so a higher percentage of their take-home pay goes to necessities," Sharga said. "The higher the inflationary environment, the more risks that those borrowers will get to the point where they have to choose whether to pay for food or the mortgage."

Metro areas like Atlanta, Houston, San Antonio, Philadelphia and Riverside in California all have high concentrations of FHA borrowers, according to Sharga.

Overall, the senior industry attorneys and analysts who spoke to Law360 agreed that the US housing market is in far better shape than it was in the lead-up to the Great Recession.

In fact, precisely because of that devasting crash, underwriting standards have since grown much tighter, meaning American families tend to have mortgages they can afford and more equity in their homes after making larger down payments than was customary during the boom years of the early 2000s.

Additionally, record low interest rates before and especially during the pandemic mean that even those who bought at peak prices since 2020 have locked in historically favorable terms for the long term. As recently as January, the share of adjustable rate mortgages hovered at only about 3% of all loans before growing to approximately 10% by May due to increases in fixed-rate mortgage rates, according to data from the Mortgage Bankers Association.

"The truth is, if you are sitting on 20, 30, 40% equity and a 3% mortgage, if you don't have to, you're not going to sell. You'll just wait for market conditions to improve," said Sharga.

Above all, what continues to favor homeowners is a persistent and acute shortage of available and affordable residential properties across classes and nationwide, which the White House estimates at more than 1 million, after construction and real estate industries curtailed building in response to the 2008 crisis.

With millennials now officially the largest generation in American history, demographic pressure is bound to sustain high home prices even amid a mild to moderate downturn, the people who spoke to Law360 said.

Nevertheless, there is little doubt that certain indicators have started to turn.

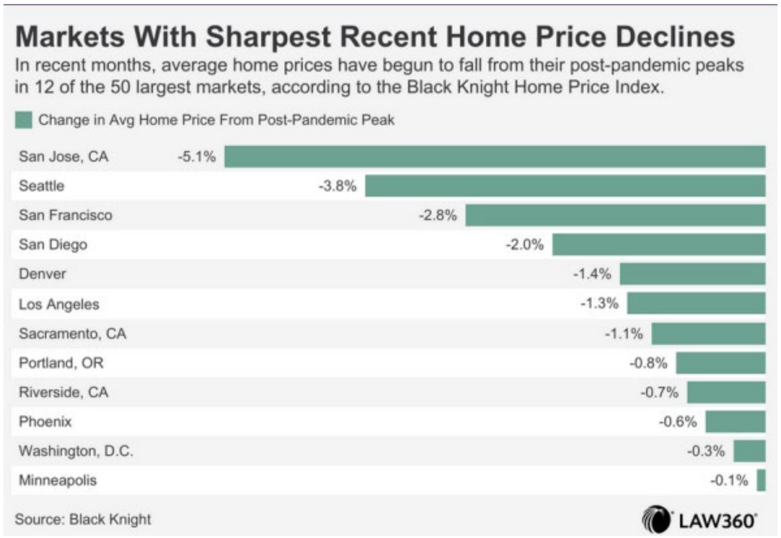
"Mortgage delinquencies have fallen to record lows early this year driven by strong credit quality and broader economic factors alongside significant savings locked in by borrowers refinancing into record low mortgage rates in recent years," said Andy Walden, vice president of enterprise research strategy at Black Knight, a Florida-based real estate data and analytics firm.

"That said, rising interest rates and stubbornly high inflation are expected to put increasing pressure on homeowners' monthly cash flows with rising debt to income rations and lower credit scores among recent originations also expected to put pressure on mortgage performance," he wrote in an email.

Pending home sales in June declined 8.6% over May and 20% year-on-year, according to the National Association of Realtors.

Nationwide, the extraordinary growth in home prices has also begun to slow in recent months, through the average home price hit another all-time-high in June, according to Walden.

“Prices have begun to pull back from their recent peaks in 12 of the 50 largest markets, with prices down by 1% or more in 7 of those markets,” Walden wrote. “San Jose has seen the sharpest decline with the average home price in the area now down 5% from April’s peak, followed by Seattle, San Francisco, and San Diego.”



The decline has only marginally eroded homeowners’ historically large equity thus far.

According to Walden, only 0.15% of borrowers, or around 9500, are underwater in the seven markets with home price decreases on 1% or more, and another 1% have less than 10% equity. In contrast, Walden said, in 2010, some 27% of homeowners were underwater in similarly situated markets and an additional 9% had near-negative equity positions.

Yet certain borrowers along the edges, such as those with VA or FHA loans, might sill find themselves with less of a cushion against inflation.

A different subgroup of recent homebuyers to keep tabs on, according to Joel Kan, associate vice president for industry surveys and forecasts at the Mortgage Bankers Association, comprises those who purchased single-family homes at the highest price point in the past year or so in states like Idaho and Utah, where many escaped to during the pandemic.

“These are states that are used to big swings like California, Arizona, Nevada, Florida. They might get hir hard by a crisis but typically bounce back,” said Kan. “But other states like Idaho, Utah that have seen a big upswing in home prices in the last six months. Is that sustainable? Was there any overbuilding?” Kan said.

Boise, Idaho; Austin, Texas, Phoenix and areas of Utah have all experienced extraordinary increases in prices for median home sales since early 2020, in the range of 50% or more, according to data provided by ATTOM.

Now, these are among the markets witnessing “the strongest levels of cooling,” according to Walden of Black Knight.

The fate of homeowners who took out mortgages to buy in those areas is now ties up with the ongoing push and pull over remote work and whether employers ultimately force existing or new staff back to the office.

According to Michael J. Romer, co-founder and managing partner of boutique real estate law firm in Manhattan, that's the case for more and more businesses, especially small-to-medium sized ones.

"For those individuals who bought our of town at unusually high prices, selling and moving back might be harder when property valuation isn't the same," Romer said.

New York, Illinois, and California lost the largest share of residents from 2020 to 2021, while Idaho, Utah, Montana, Arizona, and Texas gained the most percentage-wise, according to data crunched by the Pew Charitable Trusts.

Even if turmoil materialized at some level in these markets, as well as in the market for government-backed mortgages, none of the industry pros Law360 spoke to expects it to impact a large-enough number of people to have repercussions at the national level, unless the downturn is far more severe than currently forecasted.

"If we do hit a recession in the next 12 months, and we have higher than expected unemployment rates, that could change the equation considerably," said ATTOM's Sharga.

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